



APPENDIX

A

Statutes Involved

The controlling Statutes are the following subdivisions of the Internal Revenue Code:

"Sec. 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

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"(b) **Interest.**—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter."

"Sec. 24. Items Not Deductible.

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"(b) Losses from Sales or Exchanges of Property.—

"(1) **Losses disallowed.**—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(A) Between members of a family, as defined in paragraph (2)(D);

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

“(c) Unpaid Expenses and Interest.—In computing net income no deduction shall be allowed under section 23(a), relating to expenses incurred, or under section 23(b), relating to interest accrued—

(1) If such expenses or interest are not paid within the taxable year or within two and one-half months after the close thereof; and

(2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

(3) If, at the close of the taxable year of the taxpayer or at any time within two and one-half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under section 24(b).”

“Sec. 43. Period For Which Deductions and Credits Taken.—

“The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which ‘paid or accrued’ or ‘paid or incurred,’ dependent upon the method of accounting

upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer whose net income is computed upon the basis of the accrual method of accounting, amounts (except amounts includible in computing a partner's net income under section 182) accrued as deductions and credits only by reason of the death of the taxpayer shall not be allowed in computing net income for the period in which falls the date of the taxpayer's death."

B

Committee Reports

H. Doc. No. 337, 75th Cong., 1st Sess., pp. 15-16:

**"5. ARTIFICIAL DEDUCTIONS FOR INTEREST
AND BUSINESS EXPENSE.**

"The committee had presented to it certain cases wherein individuals were indebted to each other or corporations were indebted to the principal stockholders. In fact it was pointed out that personal holding companies were being utilized for the purpose of establishing artificial deductions. The sole stockholder (or a member of his family) of a personal holding corporation borrowed all or a major part of its annual net income and paid interest thereon. In such cases the debtor kept his books and tax returns on the accrual basis and claimed as deductions the accrued interest. On the other hand, the creditor who was entitled to such payments, if he were on the cash

receipts basis, would not be required to report for income tax purposes, the amount owing to him until actual receipt of the money. Under such circumstances the discharge of the debt may be postponed for an unreasonable length of time with the result that the Government is delayed in getting its tax and in many cases the payments fall in a year of no income with the result that little or no tax is paid. The committee believes that such practices between individuals of a family or between corporations under common control should be dealt with in such a manner as to encourage reasonably prompt discharge of such obligations.

"It is, therefore, recommended that in the case of a transaction between persons, who under section 24(a)(6) are not permitted a deduction for loss from sale or exchange of property, where the debtor makes his return on the accrual basis and the creditor makes his return on the cash basis, deductions—under section 23(a), (expenses) and under section 23(b), (interest)—accrued by the debtor within the taxable year but not paid within $2\frac{1}{2}$ months after the close of the taxable year should be disallowed.

"This proposal should serve to stimulate reasonably prompt payment of such accrued expenses in order that the debtor may secure the allowance of the deduction. No hardship should result from the requirement that the amount be paid within $2\frac{1}{2}$ months after the close of the year of accrual since expenses of this nature usually should be paid within that time in the

ordinary course of business. While this restriction would be applicable only to individuals and corporations in relationships covered by section 24(a) (6), this class represents the worst offenders in the use of this loop-hole."

H. Rep. No. 1546, 75th Cong., 1st Sess., p. 31 (1939-1 Cum. Bull. (Part 2) 704, 724-725):

"SECTION 301 OF THE BILL—UNPAID EXPENSES AND INTEREST.

"Section 301 also adds to section 24 of the 1936 act a subsection (c) which denies deductions for unpaid expenses and interest in certain cases. Under existing law, some individuals have attempted to take advantage of the difference in operation between different accounting methods of reporting income to obtain artificial deductions for interest and business expenses. For example, it was found that an individual on the accrual basis became indebted either to an individual with whom he enjoyed a special relationship, such as a member of his family, or to a corporation which he controlled, and his creditor reported income on the cash basis. Thereafter as interest became due on the indebtedness, the debtor on the accrual basis reported the interest as a deduction for income-tax purposes, but he did not make any actual payment to his creditor. Since the creditor was on a cash basis, he reported no income and thus the sum involved escaped income tax altogether, for usually in these cases if the payment were finally made it was done at a time when the cred-

itor had offsetting losses. The use of this device as a practical matter is restricted to situations where the parties occupy special relationships to each other because an ordinary bona fide creditor would not permit his debtor to engage in such a practice.

"Your committee recommends that section 24 of the Revenue Act of 1936 be amended by adding a new subsection under which it is provided that where the creditor, by reason of his method of accounting, is not required to include in his gross income the amount of the expenses or the interest until it is paid, no deduction shall be allowed to the debtor under section 23(a) (for expenses) or section 23(b) (for interest) for sums not paid by the debtor during his taxable year or within 21½ months after the close of such taxable year. This provision is limited in its application to cases in which both the taxpayer and the person to whom the payment is to be made are, at the close of the year of the taxpayer or at any time within 21½ months thereafter, persons between whom losses would be allowed under section 24(b)."

C

Treasury Regulations 103

"Sec. 19.42-2. Income not reduced to possession.—Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then

actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. If a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt."

"Sec. 19.42-3. Examples of constructive receipt.—

If interest coupons have matured and are payable, but have not been cashed, such interest, though not collected when due and payable, shall be included in gross income for the year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. The interest shall be included in gross income even though the coupons are exchanged for other property instead of eventually being cashed. The amount of defaulted coupons is income for the year in which paid. Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. If a dividend is declared payable on December 31 and the corporation intended to and did follow its practice of paying the dividends by checks mailed so that the shareholders would not receive them until January of the following year, such dividends are not considered to have

been unqualifiedly made subject to the demand of the shareholders prior to January, when the checks were actually received. As to the distributive share of the profits of a partner in a partnership, see section 188. Interest credited on savings bank deposits, even though the bank nominally has a rule, seldom or never enforced, that it may require so many days' notice before withdrawals are permitted, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, has a taxable status as income for the year of the credit. If the amount of such accumulations does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder is income for the year of the maturity of the share."

D

List of cases involving the construction of Section 24(c) decided by the Tax Court between February 19, 1941, and June 19, 1945:

1. Fincher Motors, Inc., 43 B. T. A. 673 (Feb. 19, 1941).
2. Lenox Clothes Shops, Inc., 45 B. T. A. 1122 (Dec. 30, 1941).
3. Cosmo Cleaners & Dyers, Inc., C. C. H. Dec. 12,452-B (Mar. 9, 1942).
4. The Marria Transfer Company, C. C. H. Dec. 12,459-G (Mar. 13, 1942).
5. Cheltenham & Abington Sewerage Co., C. C. H. Dec. 12,486-C (Mar. 28, 1942).

6. Bellamy Ice Cream Co., Inc., C. C. H. Dec. 12,487-B (Mar. 30, 1942).
7. Moore & McDavid Company, C. C. H. Dec. 12,823-F (Aug. 21, 1942).
8. Cowden Chevrolet Co., C. C. H. Dec. 12,823-G (Aug. 21, 1942).
9. Crown Hill Cemetery Co., C. C. H. Dec. 12,828-H (Sept. 8, 1942).
10. The Celina Manufacturing Co., 47 B. T. A. 967 (Oct. 30, 1942).
11. The Musselman Hub-Brake Co., C. C. H. Dec. 12,884-C (Nov. 10, 1942).
12. Wollner Manufacturing Co., Inc., C. C. H. Dec. 13,088(M) (Mar. 27, 1943).
13. R. Fretwell & Sons, Inc., C. C. H. Dec. 13,107(M) (Apr. 8, 1943).
14. Mansuss Realty Co., Inc., 1 T. C. 932 (Apr. 14, 1943).
15. Birch Ranch and Oil Company, C. C. H. Dec. 13,881(M) (Apr. 20, 1944).
16. Michael Flynn Manufacturing Co., 3 T. C. 932 (June 1, 1944).
17. Thomas B. Martindale, Inc., C. C. H. Dec. 14,036 (M) (July 14, 1944).
18. I. Beck & Sons, Inc., C. C. H. Dec. 14,071(M) (Aug. 1, 1944).
19. Eugene Ashe Electric Company, C. C. H. Dec. 14,097(M) (Aug. 11, 1944).
20. P. G. Lake, Inc., 4 T. C. 1 (Sept. 15, 1944).
21. Ennis Manufacturing Company, C. C. H. Dec. 14,123(M) (Sept. 15, 1944).

22. M. W. Turner, Sr., C. C. H. Dec. 14,257(M) (Nov. 29, 1944).
23. Davis B. Thornton, Transferee, C. C. H. Dec. 14,324(M) (Jan. 11, 1945).
24. Lectrolite Corporation, C. C. H. Dec. 14,530(M) (Apr. 20, 1945).
25. Nock Fire Brick Company, C. C. H. Dec. 14,527 (M) (Apr. 21, 1945).
26. The Bellows Company, C. C. H. Dec. 14,532(M) (Apr. 25, 1945).
27. J. R. Holsey Sales Co., C. C. H. Dec. 14,551(M) (May 8, 1945).
28. Ohio Battery & Ignition Co., 5 T. C. No. 32 (June 19, 1945).

